



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Scott P. Johnson

SUBJECT: SEE BELOW

DATE: November 23, 2010

Approved

Date

11/24/10

COUNCIL DISTRICT: City-Wide
SNI AREA: NA

SUBJECT: INDEPENDENT ACCOUNTANT'S REPORT ON APPLYING AGREED-UPON PROCEDURES FOR THE MANAGEMENT OF THE SAN JOSE CONVENTION CENTER AND CULTURAL FACILITIES FOR THE FISCAL YEAR ENDED JUNE 30, 2010

RECOMMENDATION

Accept the Independent Accountant's Report on Applying Agreed-Upon Procedures for the Management of the San José Convention Center and Cultural Facilities for the fiscal year ended June 30, 2010 and direct staff to develop a Corrective Action Plan to address report findings.

OUTCOME

Upon approval of staff's recommendation, a Corrective Action Plan will be developed to strengthen internal control areas related to the findings in the Independent Accountant's Report on Applying Agreed-Upon Procedures for the Management of the San José Convention Center and Cultural Facilities by Team San Jose, Inc. (TSJ) for the fiscal year ended June 30, 2010 (Agreed-Upon Procedures Report).

BACKGROUND

On August 18, 2010, TSJ was served with a notice of Default under Section 6.2 of the "AGREEMENT FOR THE MANAGEMENT OF THE SAN JOSE CONVENTION CENTER AND CULTURAL FACILITIES BETWEEN THE CITY OF SAN JOSE AND TEAM SAN

JOSE, INC.” dated January 27, 2009 (Management Agreement). Section 10.6 of the Management Agreement provides: “operator shall at all times comply with the applicable Adopted Operating Budget, and shall not deviate in any substantial respect therefrom.” The City determined that TSJ’s expenditures in FY 2009-10 had exceeded the approved Budget by more than \$750,000. Additionally, TSJ was notified that the City would cause an Agreed Upon Procedures Audit (AUP) to be conducted as part of an initial Corrective Action Plan to address the default. The scope of this audit included a testing of an expanded number of transactions of operating revenues and expenses, including an evaluation of the legitimacy of the expenses in accordance with the Management Agreement. Additionally, the control policies and procedures related to revenues, expenses, disbursements, and budgetary management were reviewed.

The City and TSJ signed an engagement letter and an addendum to the original engagement letter (Engagement Letter) for the agreed upon procedures (AUP) on October 18, 2010 and November 4, 2010, respectively. The Engagement Letter confirmed the understanding of the nature and limitations of the AUP audit to be performed by the City’s external auditor, Macias Gini & O’Connell, LLP (MGO). MGO completed its fieldwork and submitted the attached final report to the City on November 24, 2010.

ANALYSIS

MGO’s performed a total of 12 procedures during the course of their review and noted five findings. The procedures and findings are summarized below:

1. MGO obtained written policies and procedures on expenses and disbursements and randomly selected and tested sixty (60) operating expense transactions which were recorded during the year ended June 30, 2010, that are not controlled by the City. For each transaction selected, MGO evaluated the allowability of the expense in accordance with the Management Agreement.

Finding: MGO noted that while TSJ has written procedures to document the process for recording accounts payable, there are no written procedures for all expense categories shown on the financial statement. In addition, two of the expenses tested were not recorded in the correct fiscal year. The misallocation totaled \$1,462.

2. MGO tested the transactions selected in procedure #1 to determine that the expense was an appropriate operating expense and not a misallocated TSJ operating expense.

Finding: No exceptions noted.

3. MGO judgmentally selected and tested fifteen (15) TSJ Executive Management Team incentive and payroll payments from January 1 through June 30, 2010 using a listing of Executive Management Team names and payroll period end dates. MGO evaluated whether the incentive fees paid were consistent with the employees' evaluations based on personnel performance objective and whether any pay increases were authorized.

Finding: MGO noted no pay increases in the sample selected. The seven members of the TSJ Executive Management Team received incentive fee payments totaling \$111,883 on February 15, 2010 for achieving performance objectives for the period from July 1 through December 31, 2009.

4. MGO obtained the PACE Revenue Report that lists the events that occurred during fiscal year ended June 30, 2010 and tested the allocation of the revenues generated from the events that were \$75,000 or greater by tracing the events to the amounts recorded in the general ledger.

Finding: Out of the 43 transactions tested that exceeded the \$75,000 or greater threshold, no exceptions were noted as a result of applying the procedures. MGO did note that there was a rounding error on one transaction due to a transmission error caused by the credit card processing company during the processing of the transaction.

5. MGO obtained the TSJ policy on cash receipts and deposits and tested deposits associated with the events identified in procedure #4 for consistency with the contract and timeliness of advance receipt.

Finding: TSJ does not have written procedures for processing cash receipts and deposits. No exceptions were noted as a result of applying the procedures to the deposits selected for testing.

6. MGO randomly selected and tested twenty (20) revenue transactions from the general ledgers of TSJ and the CVB. MGO verified that these revenue transactions are properly classified as TSJ and CVB revenues by reviewing supporting documentation such as contracts and invoices.

Finding: No exceptions were noted.

7. MGO randomly selected and tested twenty (20) compensation transactions from July 1, 2009 through June 30, 2010 the general ledgers of TSJ and the San Jose Convention and Visitors Bureau (CVB using a listing of employee names and payroll period end dates. MGO verified that the transactions are not recorded in both the Center and CVB accounting records.

Finding: MGO did not find any transactions where the same employee compensation was recorded in both the Center and CVB accounting records. MGO did note that all of the employees selected for testing allocated 100% of their time to either the Center or CVB, even though these employees did not spend 100% of their time on either the Center or CVB.

8. MGO ascertained that the final budget was approved by both the Finance Committee and the Board of Directors.

Finding: The final budget was approved by the Finance Committee on June 25, 2009 and the Board of Directors on June 26, 2009.

9. MGO reconciled the approved annual budget to the budget amounts recorded in TSJ's general ledger (MAS90) and the City Council approved budget.

Finding: MGO reconciled the budget amounts approved by the Finance Committee and the Board of Directors to the monthly budget to actual report generated in TSJ's financial system MAS 90. MGO noted that TSJ's approved annual budget under reported revenues by \$60,000 and under reported budgeted expenses by \$1,087,695 compared to the City Council approved budget.

10. MGO recomputed the variance analysis of budget to actual line items for the months of November 2009, March 2010, April 2010 and May 2010 prepared by TSJ's Chief Financial Officer. MGO attempted to verify that TSJ submitted proposed budget amendments to the City for actual expenses that were trending higher than 10% and \$25,000 compared to the City Council approved budget.

Finding: MGO identified 3 line items each in November 2009, March 2010, April 2010, and May 2010 where actual amounts were trending higher than the thresholds stated above within a range from \$115,724 to \$564,414. MGO was unable to verify that TSJ submitted budget amendments to the City for additional contributions related to these line items for the four months tested.

11. MGO selected four (4) month-end journal entries posted in the general ledger during the year ended June 30, 2010 to record ticketing revenues from the Paciolan system and reconciled the total ticketing revenues posted in the general ledger to the Center's supporting documentation (i.e., Paciolan system reports, Ticket Master reports and Civic Concert ticket reports) to determine that the revenues recorded by TSJ are supported by the detailed supporting records.

Finding: MGO identified 2 facility service fees in March totaling \$5,770 that did not have any supporting documentation for the revenues recorded

12. MGO selected four (4) month-end journal entries posted in the general ledger during the year ended June 30, 2010 to record revenues earned from events held at the Technology Museum and tracked using the Tessitura system. MGO obtained supporting documentation from the Tessitura system to determine that the revenues for the months selected reconciled to the amounts reported in the general ledger.

Finding: Revenues earned in May 2010 were consolidated with June 2010 revenues and recorded as one journal entry. Revenues in the consolidated journal entry were \$107 higher than the supporting documentation based on actual ticket counts. As the journal entry did not show a breakdown of May 2010 and June 2010 revenues, MGO was unable to determine whether the overstatement applied to May or June, or whether the overstatement should be allocated to both months.

The above findings demonstrate the need for staff to develop a Corrective Action Plan that ensures TSJ strengthens internal control areas related to revenues, expenses, disbursements, and budgetary management.

EVALUATION AND FOLLOW-UP

Upon Council's acceptance and approval of this staff report and related AUP Audit by MGO, staff will develop a Corrective Action Plan to address internal control deficiencies noted in the Agreed-Upon Procedures Audit Report and provide a status report to the City Council. It is currently anticipated that the Corrective Action Plan will be presented to Council in January 2011.

PUBLIC OUTREACH/INTEREST

- ☐ **Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- ☐ **Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- ☐ **Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

Although this memorandum does not meet any of the above criteria, the item will be posted on the City's website for the December 7, 2010 Council Agenda.

COORDINATION

This memorandum has been coordinated with the City Attorney's Office, the City Manager's Offices of Budget and Economic Development, and the City Auditor's Office.

HONORABLE MAYOR AND CITY COUNCIL

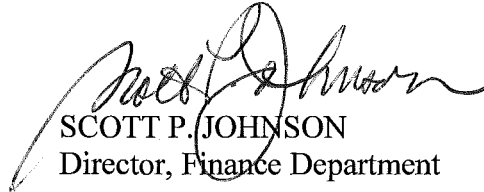
November 23, 2010

Subject: Independent Accountant's Report – San Jose Convention Center and Cultural Facilities

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CEQA

Not a project, File No. PP10-069 9 (a), Staff Reports, Assessments, Annual Reports, Information Memos.



SCOTT P. JOHNSON
Director, Finance Department

For questions please contact Scott P. Johnson, Director of Finance, at (408) 535-7001.

**SAN JOSE CONVENTION
AND CULTURAL FACILITIES**
(An Activity of the City of San José)

Independent Accountant's Report On
Applying Agreed-Upon Procedures

For the Year Ended June 30, 2010



City of San José and Team San José
City of San José, California

**Independent Accountant's Report On
Applying Agreed-Upon Procedures**

We have performed the procedures enumerated below, which were agreed to by the management of City of San José (City) and Team San José (TSJ) (collectively, "the specified parties"), solely to assist the City in evaluating TSJ's response to the City's Notice of Default issued on August 18, 2010. The City and TSJ's management is responsible for the presentation of the operating revenues and expenses of the San José Convention and Cultural Facilities (Center) in accordance with generally accepted accounting principles and for selecting the criteria and determining that such criteria are appropriate for the City's purposes. The City and TSJ's management are also responsible for making all management decisions and performing all management functions; for designating an individual with suitable skill, knowledge, and/or experience to oversee any comments that we provide as a result of our tests of transactions; and for evaluating the adequacy and results of those services and accepting responsibility for them. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

Our procedures and findings are as follows:

1. We requested and read the TSJ written policies and procedures on expenses and disbursements related to the following financial statement line items:

- Utilities
- Administrative and General Salaries - Team San José
- Cost of Event Production Labor
- Contracted Outside Services
- Professional Services
- Operating Supplies
- Repairs and Maintenance
- Insurance
- Equipment Rentals
- Other Expenses.

We randomly selected and tested sixty (60) operating expense transactions recorded in the general ledger accounts which comprise the line items listed above during the year ended June 30, 2010 and which are not operating expenses controlled by the City. For each transaction selected, we evaluated the allowability of the expense in accordance with the Agreement for the Management of the San José Convention Center and Cultural Facilities Between the City of San José and Team San José, Inc. (the Agreement) dated January 27, 2009 and amended February 2, 2010.

Finding: While TSJ has written procedures in place to document the process for recording accounts payable, TSJ does not have written procedures for the financial statement line items identified above. In addition, 2 out of the 60 expense transactions that we tested were not recorded in the correct fiscal year. The misallocation totaled \$1,462.

2. We tested the transactions selected in procedure #1 to determine that the expense was an appropriate Center operating expense and not a misallocated TSJ operating expense.

Finding: No exceptions were noted as a result of applying the procedures.

3. We judgmentally selected and tested fifteen (15) TSJ Executive Management Team incentive and payroll payments from January 1 through June 30, 2010 using a listing of Executive Management Team names and payroll period end dates. We evaluated whether the incentive fees paid were consistent with the employees' evaluations based on personal performance objectives and whether any pay increases were authorized.

Finding: We tested for incentive fees and pay increases during the period from January 1 through June 30, 2010 and noted no pay increases in the sample selected. The seven members of the TSJ Executive Management Team received incentive fee payments totaling \$111,883 on February 15, 2010 for achieving performance objectives for the period from July 1 through December 31, 2009.

4. We obtained the PACE Revenue Report that lists the events that occurred during fiscal year ended June 30, 2010 and tested the allocation of the revenues generated from the events that were \$75,000 or greater by tracing the events to the amounts recorded in the general ledger.

Finding: Out of the 43 transactions that we tested that exceeded the \$75,000 or greater threshold, no exceptions were noted as a result of applying the procedures. We did note that there was a minor rounding error on one transaction due to a transmission error caused by the credit card processing company during the processing of the transaction.

5. We requested the TSJ policy on cash receipts and deposits and tested advance deposits associated with the events identified in procedure #4 for consistency with the contract and timeliness of advance receipt.

Finding: TSJ does not have written procedures for processing cash receipts and deposits. No exceptions were noted as a result of applying the procedures to the deposits selected for testing.

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Finding: No exceptions were noted as a result of applying the procedures.

7. We randomly selected and tested twenty (20) compensation transactions from July 1, 2009 through June 30, 2010 using a listing of employee names and payroll period end dates. We verified that the transactions are not recorded in both the Center and CVB accounting records.

Finding: We did not find any transactions where the same employee compensation was recorded in both the Center and CVB accounting records. We did note that all of the employees selected for testing allocated 100% of their time to either the Center or CVB even though these employees did not spend 100% of their time on either the Center or CVB.

8. We ascertained that the final budget was approved by both the Finance Committee and the Board of Directors.

Finding: The final budget was approved by the Finance Committee on June 25, 2009 and the Board of Directors on June 26, 2009.

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We were not engaged to, and did not, conduct an audit, the objective of which would be the expression of an opinion on the expanded scope of testing of operating revenues and expenses of the Center as of and for the year ended June 30, 2010. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the specified parties and is not intended to be and should not be used by anyone other than those specified parties.

Macias Gini & C Connell LLP
Certified Public Accountants
Walnut Creek, California

November 23, 2010